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Supreme Court of the United States

OCTOBER TERM, 1940

No. 465.

IN THE MATTER

of

DEEP ROCK OIL CORPORATION, a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,

against

JOHN M. TAYLOR, *et al.*

PETITIONER'S REPLY TO RESPONDENTS' BRIEFS.

A. LOUIS FLYNN
JACOB K. JAVITS
WILBUR J. HOLLEMAN
SELIG J. LEVITAN
Counsel for Petitioner.

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POINT I.

RESPONDENTS' BRIEFS ERRONEOUSLY ASSERT THAT PETITIONER SEEKS TO RE-LITIGATE ISSUES ALREADY DECIDED BY THE *TAYLOR* CASE.

1. By loose reading of the reference of this Court to the *Taylor* case in *Pepper* v. *Litton*,[1] respondents find support for their assumption that this Court has already decided, adversely to Standard, the basic issue raised in the petition: whether this Court, in the *Taylor* case, subordi-

[1]308 U. S. 295, 60 S. Ct. 238 (1939).

nated Standard's claim as a creditor to the aggregate of the face amount of the notes, plus 6% interest to date, and to the preference on liquidation of the preferred stock plus accumulated dividends to date. We submit, however, that this Court did not use *Pepper* v. *Litton* as a vehicle for changing its mandate in the *Taylor* case. In the *Taylor* case, this Court spoke of subordination only in terms of the securities to be awarded to Standard as a creditor in the reorganization of the Debtor; the reference to the *Taylor* case in *Pepper* v. *Litton,* quoted in the briefs of respondents, also speaks of the claim of Standard being "allowed *to participate* in the reorganization of the subsidiary". This result could only receive practical expression by awarding to Standard in the reorganization of the Debtor securities junior in rank to those awarded to the preferred stockholders.

It is erroneously asserted in respondents' briefs that petitioner seeks to re-litigate issues determined in the *Taylor* case. This we flatly deny; we submit that this Court did not, in the *Taylor* case, decide the measure of subordination of Standard's claim as a creditor, but said that equitable considerations were to determine the treatment accorded Standard as a creditor in the reorganization. That is the only intimation which we can find in this Court's opinion as to what might or might not be done if the parties could not agree on a plan of reorganization.

2. Respondents argue that the contention of Standard that its claim in any event, ought not to be subordinated to the sum of the claims of note holders including interest[2]

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[2]**There is an apparent, but not a real, discrepancy between certain figures in the briefs of respondents and petitioner.**

during receivership and of preferred stockholders for the liquidating par value of the preferred stock and dividends accrued during receivership, (a) involves some repudiation of contractual liability and (b) is unsound, because to grant the contention might adversely affect the marketability of securities of corporations in reorganization. The facts do not support respondents' arguments. Petitioner does not urge any repudiation by the Debtor of its contractual liability, or the adoption of any principle (as argued by the S. E. C.) which would "destroy the marketability" of securities of corporations in reorganization. Standard has no contractual relationship with the note holders and preferred stockholders; therefore no question of repudiation of a contract is involved in the question of the measure of subordination of Standard's claim. No practical impediment exists to a reduction of the status of Standard as a creditor to a rank compatible with the equitable considerations, but the measure of this reduction is not by some law of nature or consideration of practical expediency required to be coextensive with the measure of the contractual rights against the Debtor of note holders

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At page 3 of the brief of the Reorganization Committee and at page 4 of that of the S. E. C., the value of the Debtor's assets is stated to be $16,500,000 and the debt to note holders as $13,000.000. Petitioner's brief states the corresponding figures to be $17,000,000 and $14,200,000. The apparent discrepancy is due to the fact that during the reorganization proceedings, $1,200,000 was distributed to the note holders. Restoration of this amount to both sides of the ledger does not alter the amount of the excess of assets over liabilities; however, it shows the value of assets of the Debtor to amount to $17,700,000 as against liabilities to the note holders of $14,200,000. The amount of $14,200,000 is the real measure of the priority asserted by the note holders.

and preferred stockholders upon liquidation.[3] Since subordination to any extent *must* result in an improvement in the status of the interests achieving seniority, marketability of the securities representing such interests would not be adversely affected. The question simply is the extent of the windfall to accrue in favor of such securities.

3. In neither brief of respondents is there a defense of the decision below as equitable or as consistent with the doctrine expressed in *Southern Pacific Company* v. *Bogert*.[4] The principal theme of respondents' arguments is that the decision of this Court in the *Taylor* case disposed of the issues involved in the petition, so that the harsh consequences of the order below "followed inevitably" this Court's decision in the *Taylor* case.

POINT II.

RESPONDENTS' ARGUMENT THAT SO MUCH OF THE ORDER OF FEBRUARY 29, 1940 AS DIRECTS STANDARD TO TRANSFER TO THE TRUSTEE OF THE DEBTOR THE STOCK OF THE REFINING COMPANY AND THE NOTE OF THE REFINING COMPANY "MARKED PAID", WITHOUT RECEIVING COMPENSATION, IS A RESTORATION OF THE STATUS QUO, IS CONTRARY TO THE FACTS IN THE RECORD.

1. In defense of the order of February 29, 1940, respondents contend that in effect there has been a restora-

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[3]Thus, for example, it could be provided that the holders of notes and preferred stock of the Debtor be subrogated to Standard's normal participation as a creditor to the extent of the actual cost of their securities, Standard retaining the amount of its normal participation in excess of the portion preëmpted by such subrogation.

[4]250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919).

tion of the parties to the positions which they occupied before the transaction of October 1, 1925 (in which Standard acquired the stock of the Refining Company, and the Refining Company issued to Standard its note of $1,894,592.11). (Reorganization Committee brief, p. 4; S. E. C. brief, p. 17.) It must, however, be obvious that the order fails to restore the status quo, and that it is impossible to restore Standard to the status quo. A rescission will not be ordered where it has become impossible to restore the status quo, and where one of the parties has enjoyed all the fruits.[5]

The record shows (and it is admitted in the answers) that Standard and not Deep Rock paid directly to the vendor (a stranger) $500,000 for the purchase of the Bradstreet properties (R. 294-295; R. 137). This amount was never charged by Standard to Deep Rock and was never a part of any open account indebtedness owed by Deep Rock to Standard (R. 294). The order of February 29th does not attempt to restore the status quo; indeed it alters the status quo in directing a conveyance to Deep Rock of property which it never owned. It contains no provision restoring or awarding to Standard any right in exchange for the transfer of this property.

There can be no "restoration" of any claim against the Debtor for the $500,000 paid by Standard directly to the vendor of the Bradstreet Properties, because for that amount there never was any claim against it. The only way to restore the status quo with respect to the Bradstreet Properties would be to pay to Standard the money it paid to buy that property. A restoration of the status quo in

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[5] *Stoffela* v. *Nugent*, 217 U. S. 499, 54 L. Ed. 856, 30 S. Ct. 600 (1910).

this case would in reality necessitate a refund to Standard of its net cash investment in the Refining Company of $2,082,026.30. Since 1925, the Debtor has enjoyed the fruits of the Refining Company properties, while conditions have so changed that the restoration of a claim against it would be a nebulous consideration.

The attempt to distinguish the *Bogert, Brownville* and *Furlaud* cases at pages 17-18 of the brief of the S. E. C., fails to give due regard to the facts. As we have stated, title to the Bradstreet Properties was never in the Debtor. Further, since October 1925, Standard has expended the sum of $41,706.25 (plus an additional $8,227.94 since the beginning of the receivership) to preserve the property and corporate status of the Refining Company (R. 1332 A, B). We submit that the most fundamental concepts of equity, often expressed by this Court, have been violated by the decisions below.

2. Standard did not receive a due hearing with respect to the matters encompassed in the Refining Company petition. On January 29 and 30, 1940, when hearings took place before the Court, issue had not been joined on Standard's petition, as admitted in the brief of the S. E. C. (p. 21). Indeed, one of the answers to the petition was not filed until April 23, 1940 (R. 147). Standard knew on January 30, 1940 that issue would be joined in the future, but that is obviously not the same as issue already being joined.

On pages 1316 to 1317 of the Record it appears that on February 27th, Standard's counsel requested of the District Court the privilege of addressing himself to the Refining Company petition, and that the Court declined to permit argument, stating "I am trying to fix it so you will

get your appeal." The Court had already stated "I have already made up my mind, and nobody can change it now" (R. 1314). From the juxtaposition of these events, from the refusal of the District Judge to make separate findings of fact and conclusions of law with respect to the Refining Company petition (R. 159), and from the finding of fact by the District Judge that the claims of Standard with respect to the Refining Company property are of "identical character of all other claims" of Standard against the Debtor (R. 150)—a finding which cannot be sustained from the record, as we have shown—it is apparent that the District Court rested his determination not on the evidence with respect to the Refining Company but rather on the assumption that this Court by its decision in the *Taylor* case had completely foreclosed Standard from participation in the reorganization and had required Standard to transfer to the Debtor, without compensation, its interests in the Refining Company.[6]

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[6]The petition of January 29, 1940 relating to the Refining Company property is not, as respondents state, a restoration of the items in the original claim amended in the proof of debt. By the petition of January 29, 1940, Standard offered two alternatives: (1) that it transfer to the Debtor the Refining Company properties and stock in the Refining Company, free and clear of the note, receiving in return the amount of its investment with fair compensation, or (2) that Standard be permitted to recover possession of the Refining Company property and be paid fair compensation for the use of such property by the Debtor, its receiver and trustee. Under the original claim, Standard retained the property and claimed a rental, the amount of which exceeded the amount claimed by Standard under either alternative offered in the petition of January 29, 1940.

CONCLUSION.

In denying to Standard any participation as a creditor in the reorganization of the Debtor, the District Court rendered a decision which he considered inequitable. The Circuit Court did not attempt to defend the justice of that decision. Neither have the respondents. All have apparently assumed that injustice will be tolerated as the necessary consequence of the opinion and mandate of this court in the *Taylor* case.

The brief of the Reorganization Committee urges this Court to promote an injustice in order to avoid further delay in consummation of the reorganization. Delay cannot be charged Standard; the same Reorganization Committee and the Trustee both supported the plan of reorganization which this Court disapproved in 1939. It is indeed a novel suggestion to this high Court that in the interests of expediency it sanction injustice.

We respectfully submit that the petition for certiorari should be granted in this case.

Dated: October 24, 1940.

Respectfully submitted,

A. Louis Flynn
Jacob K. Javits
Wilbur J. Holleman
Selig J. Levitan
Counsel for Petitioner.